

In the High Court of Judicature at Madras

Dated: 08/12/2003

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The Hon'ble Mr. Justice R. Jayasimha Babu
and
The Hon'ble Mr. Justice S.R. Singaravelu

Tax Case No.104 of 2000

The Commissioner of
Income-tax,
Tamilnadu I,
Madras. ... Applicant

-Vs-

M/s. S.I. Property
Development Pvt. Ltd.
Madras Respondent

Tax case under Section 256 (1) of the Income Tax Act, 1961 against the order made by the Income Tax Appellate Tribunal, Madras "B Bench, Chennai, in I.T.A. No: 1255/(Mds)/1998 dated 04.09.1992 for the assessment year 1984-85.

!For applicant : Mr. K. Subramaniam
Senior Standing counsel for
Income tax

^For respondent : Mr.V. Ramachandran,
Senior Counsel for
M/s. Anitha Sumanth

:O R D E R

(Order of the Court was
made by R. Jayasimha Babu, J.)

The assessment year is 1984-85. The question referred is,
" Whether on the facts and in the circumstances of the case, the Income-tax Appellate Tribunal was right in law in holding that the deposits of Rs.15 lakhs made by M/s.Southern Investments with the assessee-company were not to be connected with the Bangalore Project to say that the interest paid thereon was the cost of construction of the project ?"

2. The assessee entered into an agreement on 5th January 1983 with a

partnership firm Southern Investments which is referred to in the body of the agreement as a firm which owns a trade mark "S.I.". The assessee company is part of the same group as is obvious from the very name of the assessee.

3. The agreement sets out, inter alia, that the assessee had entered into an agreement with the owners of a plot on Palmgrove road, Bangalore, that it had nominated three persons to purchase the property, that it was required to provide finance to those persons for the purchase of the property; that the projected cost of construction was Rs.75 lakhs; that the firm which had experience in the real estate field had agreed to act as a marketing and selling agent of the assessee for the proposed project and was willing to deposit a substantial sum as interest bearing security deposit to help the builders to finance the project; and to guarantee the builders a minimum final sale value for the project. The agreement in its several clauses refers to the 'project' which is the project on the schedule property. The firm which is described in the agreement as an agent was to underwrite a minimum net realisation of Rs.140 lakhs; bear all expenses in connection with the marketing and selling of the project; and pay 85 per cent of the collections from the prospective clients who would purchase portions of the building to the assessee every month for the purpose of construction.

4. The agent firm was also required to pay a sum of Rs.10 lakhs as security deposit on execution of the agreement and make a further deposit of Rs.5 lakhs at the time of approval of the plans for construction. The deposit so made was to bear interest at the rate of 24 per cent. The amount of that deposit was to be adjusted by the agent from the sale receipts of the project. The agent enjoyed a similar right to adjust the interest on that amount of deposit, and for that purpose the interest was to be calculated on the monthly balance. The agent was to pay to the assessee the sum of Rs.140 lakhs even if the agent fail to realise the sum by effecting sales of the portions of the building. The agent was further required to, if so demanded by the assessee, purchase unsold portions at the value determined by the assessee.

5. Under the head 'obligations of the builders' it was set out in that agreement, that the construction was to be put up by the assessee in consultation with the agent and that the assessee was not in any manner to delay or withhold the construction of the project and that it was the obligation of the assessee to "..... arrange at the risk and cost of the agent any additional finance required to continue and complete the proposed constructions".

6. The assessee was required to pay to the agent a fee of 8 per cent of the total sale receipts as marketing fee. The assessee claimed from its profits for this assessment year a sum of Rs.3.2 lakhs which it had paid to the agent under that agreement as business expenditure. That claim was disallowed by the assessing officer after observing that, "... it is the practice followed by the assessee Company to take all incomplete project expenses as work-in-progress and show it in the Balance Sheet. Therefore, the interest paid on security deposit received for "Palm Tree Place" project, of which work-inprogress is shown at Rs.26,69,304/-, should have been accounted as part of work-in-progress of that project and ought not to have been claimed

as a deduction in the main profit and loss account as the same goes to reduce the profit from another project. Therefore, this amount will only be considered as part of work-in-progress under the project 'Palm Tree Place' "

7. That view of the assessing officer was affirmed in appeal by the Commissioner. The Commissioner, after considering the terms of the contract, concluded that,

" Thus, the tenor of the agreement shows that it was entered into with the specific purpose of financing the Bangalore project known as the "Palm Tree Place Project" and the deposit received was to enable the assessee to finance this project. The deposit was also taken by the assessee as a guarantee that a minimum final sale value would be obtained for this project by the agent."

The Commissioner further noted that there was no material to hold that the sum of Rs.15 lakhs received under this agreement for this project had been deployed or utilised by the assessee for any other project or that it had treated the same as part of its general working capital.

8. The assessee, however, was successful in persuading the tribunal not to treat this as part of the project cost. The Tribunal while accepting the assessee's case held,

" Thus it is clear that the funds made available to the assessee were not so inextricably connected with the project so as to say that the interest paid thereon was the cost of construction of the project."

9. It is evident from the recitals as also the mutual obligations set out in this agreement that the agreement was in relation to a project which was for construction of a multi storey building on the land described in the schedule to that agreement; that the cost of the land was Rs.20 lakhs and the cost of the construction was Rs.75 lakhs; on the date of the agreement, the sale of the land had not been completed; that the assessee had undertaken to provide funds to the persons nominated by it to be shown as the purchasers in the sale deed for the land; that the deposit of a substantial sum by the agent as interest bearing security was to help the assessee to finalise the project and also to guarantee to the assessee a minimum final sale value and that the assessee was to arrange at the risk and cost of the agent any additional finance required to continue and complete the proposed construction. Having regard to what has been set out in the agreement, it is not possible to sustain the Tribunal's view that the deposit was not linked to the project.

10. The deposit indeed was obtained solely for the purpose of financing the part of the cost of the project and the interest paid for obtaining such finance - though the amount is described in the agreement as security deposit - was in fact an expenditure which was in relation to this project and no other project. The use of the words ' additional finance' in clause II (b) of the agreement reinforces this view as the deposit paid under the agreement has been regarded by the parties as part of the finance required for the project and for obtaining additional finance, the agent had agreed to take the risk involved in obtaining such finance and also be responsible and liable for the cost of obtaining such additional finance.

11. Learned senior counsel for the assessee, however, submitted that

as the assessing officer had used the term "work-in-progress", this finance cost could not possibly be regarded as part of the work-inprogress and that the treatment of this interest as part of the workin-progress was wholly unjustified. Though this argument on the face of it looks attractive, all that the assessing officer has said is that it had been the practice of the assessee company to account all the expenditure in relation to a project which was incomplete at the end of the assessment year as part of work-in-progress and that the assessee was in error in not including this cost also, which was related to the project, in that amount which the assessee has described as work-in-progress. What was really in issue before him was not as to whether this is an amount which can be regarded as part of the workin-progress and was required to be excluded therefrom. He was of the view, and in our opinion rightly, that it was required to be treated as part of the project cost.

12. Learned senior counsel also drew our attention to the Standards of Accounting AS-7 "Accounting for construction Contracts", more particularly para 8.7 therein which sets out the examples of costs that relate to the activities of the contractor generally, but cannot be related to specific contracts, one such cost set out therein being the finance cost. It was submitted by counsel that all interest paid on the deposit even if it be regarded as finance cost was required to be excluded from the cost of the project.

13. In the same accounting standard at para 8.8 it has been made clear that,

" However, in some circumstances general administrative expenses, development costs and finance costs are specifically attributable to a particular contract and are sometimes included as part of accumulated contract cost."

Thus, all that the accounting standard provides is that if the finance cost and other costs such as the general administration and selling cost, research and development cost are contract specific then, such costs are required to be included as part of the project cost. In cases where such costs are specifically attributable to the particular contract they are to be included as part of the project cost.

14. In this case, interest paid on the deposit was in fact interest paid on an amount which had been received by the assessee for the specific purpose of completing the project and that was also the manner in which the agent who paid that sum had viewed it despite the fact that the description of the sum so paid was 'deposit'. The deposit was, under the terms of the contract, adjustable at the instance of the agent from and out of the moneies payable by the agent to the assessee. The project itself was to be financed with the aid of the deposit obtained by the assessee, and by obtaining further funds at the cost and risk of the agent. In this case, the relation of the agent here was not merely that of a marketing and selling agent, but was in fact that of a financier which provided part of the finance required directly, and agreed to remain liable for the additional finance which the assessee was to secure.

15. The question referred is, therefore, answered in favour of the revenue and against the assessee.

Index : Yes

Website : Yes

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To

1. The Assistant Registrar,
Income Tax Appellate Tribunal,
Rajaji Bhavan, III Floor,
Besant Nagar,
Madras - 90.

2. The Secretary,
Central Board of Revenue,
New Delhi.

3. The Commissioner of
Income Tax,
Tamil Nadu I,
Madras.

4. The Commissioner of
Income Tax,
Appeals V,
Madras.

5. The Inspecting Assistant
Commissioner of Income Tax
(Assessment),
Range I,
Madras.

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